United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-7305

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

B

No. 76-7305

JAMES ARNEIL, VERNON A. STOCKWELL

Plaintiffs-Appellants

-against-

JAMES B. RAMSEY, JR., OLIVER DeG. VANDERBILT, WILLIAM M. LENDMAN, BLAIR & CO., INC., THE NEW YORK STOCK EXCHANGE,

Defendants-Appellees.

On Appeal from the United States District Court
Southern District of New York

BRIEF FOR PLAINTIFFS-APPELLANTS

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Statement of the Issues

The issues on appeal pursuant to 28 U.S.C. Section 1291(b) are:

1. Whether a New York State Court would apply the "grouping-of-contacts" principle to the non-negligent tort of fraud in determining the place where such a cause of action ac-

crues for purposes of the New York "borrowing statute";

2. Whether the opinion of this Court in Sack v. Low, 478 F.2d 360 (2d Cir. 1974) required the Court below to find that the causes of action for fraud alleged in the case at bar accrued in the State where plaintiffs reside, even though (i) substantial consideration for the securities bought by plaintiffs consisted of the transfer of New York assets to the issuer, (ii) the securities bought by plaintiffs consisted of the equivalents of "open accounts" and stock located in New York, and (iii) plaintiffs' securities were so handled that their losses were completed by book entries in New York books of account and stock books;

3. Whether the Statute of Limitations began to run on plaintiffs' claims against the New York Stock Exchange and the individual defendants when plaintiffs first had information from which they might have learned that Blair & Company's frauds, even though they had no inkling the Exchange or the individual defendants might have been knowing participants in those frauds;

4. Whether under American Pipe & Construction Co. v. Utah, 414 U.S. 538 (1974) the Statute of Limitations applicable to plaintiffs' claims was tolled by the filing in another Dis-

trict of an amended class action complaint against the New York Stock Exchange covering the same claims alleged by plaintiffs;

5. Whether Section 6 of the Securities Exchange Act of 1934 imposes on the New York Stock Exchange any obligation to enact rules requiring dissemination of material information concerning a member firm of such Exchange to investors in such a firm.

Statement of the Case

Plaintiffs' appeal pursuant to 28 U.S.C. Section 1291(b) from an Order of the United States District Court for the Southern District of New York, (Brieant, J.), 1975-76 Transfer Binder CCH Fed. Sec. L. Rep. ¶95,550 (S.D.N.Y. 1976) (App. 514)*, which granted in part and denied in part the defendants' motions for summary judgment and dismissed all claims against all defendants under Section 6 of the 1934 Act.

In 1969, plaintiffs invested in secured demand note accounts and capital stock of Blair & Co., Inc. ("Blair"), a member firm of the Exchange. In April 1975, plaintiffs filed their Complaint in this action alleging, in fourteen

*References to "(App.)" are to pages of the Joint Appendix filed with this Brief.

separate counts, that the Exchange, Blair and those individuals who had been principal officers of Blair had violated Sections 6, 10(b) and 20 of the 1934 Act and common law obligations in connection with plaintiffs' investments in Blair. Jurisdiction was founded on Section 27 of the 1934 Act and principles of pendent jurisdiction.

The action as against Blair was stayed as a result of restraints issued by the Bankruptcy Court having jurisdiction over Blair's insolvency proceedings. (App. 413-21) The other defendants answered denying the substantive allegations and setting up as affirmative defenses a Statute of Limitations of the State of Washington which bars "an action for relief upon the ground of fraud" if not brought within three years of "discovery by the aggrieved party of the facts constituting the fraud." (App. 37, 43)

After appropriate discovery, the Exchange moved for summary judgment under Rule 56 FRCP on the grounds that (i) the Exchange fulfilled its Section 6 duty to enforce applicable rules and regulations, (ii) Section 6 imposes no duty upon the Exchange to enforce compliance with applicable regulations, (iii) the Exchange was under no duty to enact rules more pro-

tective of investors in plaintiffs' position that had been enacted at the time, (iv) the Exchange did not aid or abet and was not part of any violation of Section 10(b) or Rule 10b-5 by Blair or other relevant persons, and (v) all claims against the Exchange were barred by the Washington Statute of Limitations. (App. 186-95).

The individual defendants also moved for summary judgment, relying principally on the Washington Statute of Limitations. (App. 45).

Applying the Washington Statute of Limitations, the District Court granted the motions of all defendants as to Counts I through IV, which alleged violations of Section 10(b) and Rule 10b-5, and as to Count XIII, which alleged common law fraud. The Court concluded that the causes of action alleged against the Exchange only in Counts V through XII are governed by the six-year limitations period applicable to contracts and thus are not time-barred. However, the Court further concluded that Section 6 of the 1934 Act did not impose on the Exchange the duties alleged in Counts VI, IX, X and XII and that the Exchange had not been in the fiduciary relationship with plaintiffs alleged in Count XIV. Accord-

ingly, the Court also dismissed those Counts. However, the Court denied the Exchange's motion to dismiss the claims against the Exchange under Section 6 of the 1934 Act alleged in Counts V, VII, VIII and XI. Finding no just cause for delay, the Court concluded that a final judgment might be settled. (App. 537, 38). Plaintiffs duly filed their Notice of Appeal to this Court. (App. 541).

Statement of Facts

Given the standards applicable to a motion for summary judgment, it seems appropriate at the outset to enumerate those facts which are not disputed:

1. There is no dispute that both of the plaintiffs were residents of the State of Washington at all times relevant to this action (App. 46, 186);

2. There is no dispute that, although one of the plaintiffs is an attorney and other is the manager and part owner of two apple orchards, neither plaintiff has had experience as a principal in a stock exchange or stock brokerage firm or business (App. 47);

3. There is no dispute that the Exchange is re-

gistered as a national securities exchange under Section 6 of the 1934 Act and has its principal offices in the City and State of New York (App. 186);

4. There is no dispute that Blair was a member organization of the Exchange until September 1970 when the Exchange exercised its authority over Blair to appoint a liquidator for that firm and Blair ceased operations (App. 31, 35, 42);

5. There is no dispute that the individual defendants are former officers of Blair and there is no dispute that Blair and the individual defendants had their principal offices in the City and State of New York (App. 5, 38);

6. There is no dispute that, in April 1969, plaintiffs each invested in securities of Blair consisting of a secured demand note account ("SDN Account") and non-voting common and preferred stock (App. 186). Judge Brieant's findings supporting his dismissal of Count XIV establish that, for purposes of the rulings now at issue, it cannot be disputed that the relationship of plaintiffs to Blair was essentially that of "public customers" of a member firm of the Exchange and not principals of such a firm (App. 537);

7. There is no dispute that, although plaintiffs executed such documents as they executed in the State of Washington and mailed checks representing a small portion of the consideration for their SDN Accounts and/or stock, as well as some securities constituting collateral for the SDN Accounts, from Washington to New York, the SDN Accounts and the shares of Blair stock were maintained in New York (App. 133, 409);

8. There is no dispute that in 1969, when plaintiffs made the investments relevant to this action, the Exchange did not have a rule designed to ensure compliance by member firms with the Securities Act of 1933 comparable to Rule 313(d) which was not promulgated until 1971 (App. 531);

9. There is no dispute that the plaintiffs' SDN Accounts and all collateral therefor were liquidated in New York in 1970 (App. 520);

10. There is no dispute that this action was begun more than 3 but less than 6 years after the liquidation of plaintiffs' accounts with Blair;

11. There is no dispute that by the summer of 1970, before they suffered any losses, plaintiffs had become aware that certain problems Blair had been experiencing even prior

to plaintiffs' investments had not been disclosed to them by Blair (App. 48);

12. There is no dispute that the record is barren of evidence showing that plaintiffs were aware of participation by the Exchange and by the individual defendants in frauds upon plaintiffs until less than three years before commencement of this action;

13. There is no dispute that, in March 1973, well within all applicable Statutes of Limitation and before this action was commenced, a class action was commenced against the Exchange based upon the same acts and omissions of the Exchange pleaded in this action. There is also no dispute (i) that the class described in the original Complaint in that action did not include plaintiffs but, in March 1976, an Amended Complaint was allowed in which the class included the plaintiffs in this Action, and (ii) that class certification in the said class action was denied on April 30, 1976 (App. 524);

A careful review of the Opinion of the Court below discloses that these undisputed facts were the only facts which the Court considered in reaching its decision. However, the Statements submitted by the parties with respect to the

motions pursuant to Rule 9g of the General Rules of the District Court reveal additional relevant facts which the Court ignored. These facts, some of which may be divided, include:

(a) Execution of documents by plaintiffs in the State of Washington was not effective to conclude the agreements evidenced thereby since the documents contained blanks and had to be completed and accepted by Blair in New York (App. 409);

(b) The checks mailed by plaintiffs to Blair could not be negotiated until approval of the proposed transactions by Blair's Board of Directors and by the Exchange in New York. (App. 409);

(c) The Exchange made representations to plaintiffs in writing in the form of the stock purchase agreement (which required that the purchase itself be subject to approval by the Exchange) and in the form of the shareholders' agreement with the Exchange (App. 410);

(d) Prior to plaintiffs' investments the Exchange had full knowledge of the catastrophic condition of Blair which led to its ultimate bankruptcy (App. 410, 11);

(e) The false representations made to plaintiffs were made in the State of New York and insofar as there

were omissions, the duty to make true statements arose in the State of New York (App. 410);

(f) The losses suffered by plaintiffs occurred by virtue of the conversion and sale of plaintiffs' securities and of their SDN Accounts which occurred in New York (App. 410);

(g) The plaintiffs did not learn that the Exchange and the individual defendants had participated in the frauds practiced upon plaintiffs until 1973 at the earliest and then only as the result of another pending class action brought by persons similarly situated to plaintiffs. (App. 412);

If the foregoing facts are in fact relevant to a proper disposition of the motions for summary judgment, the decision below must be reversed since they were not considered by the Court below. If any are disputed, summary judgment would necessarily be inappropriate.

ARGUMENT

I

The Court below erred in holding that the Washington Statute Limitations applies to bar the fraud claims alleged in the present action.

It is well established and there is no dispute that, except as limited by the Supreme Court decision in American Pipe & Construction Co. v. Utah, 414 U.S. 538 (1974), state statutes of limitations govern causes of action under Section 10(b) of the 1934 Act. Nor is there any dispute that, sitting as it does in New York, the Court below was required to refer to New York law - including applicable conflicts of laws principles - to determine whether the statutes of limitations applicable in the present case were those of Washington or New York. Finally, there is no dispute that choice of the applicable statute of limitations in the present case should turn on the way in which a New York Court would construe and apply the New York "borrowing statute" (CPLR Section 202) given the facts of the present case. This question, in turn, would depend on the way in which a New York Court would construe language in CPLR Section 202 which makes the law of "the state where the cause of action accrued" controlling.

The error in the decision below with respect to the Statute of Limitations resulted from:

(i) the Court's adherence to the view suggested by Sack v. Low, 478 F.2d, 360 (2d Cir. 1973) that New

York Courts will always conclude that a fraud cause of action accrues in the State where the defrauded party resides;

(ii) disregard by the Court below of dictum in Sack v. Low suggesting that even the Sack v. Low court would have applied the New York Statute of Limitations given the facts of this case;

(iii) an unsupportable assumption by the Court that awareness by plaintiffs of a possible fraud by Blair was sufficient disclosure of facts concerning the Exchange's involvement in fraud for the limitation period to begin running, and

(iv) misunderstanding by the Court below of the application of American Pipe.

A. A New York State Court would apply the "center of gravity" or "grouping of contacts" doctrine in determining the place where the fraud causes of action asserted in the present case accrued.

The decision of the Court below to apply the three-year Washington Statute of Limitations and not the six-year New York Statute was based solely upon the apparent assumption that the

decision of this Court in Sack v. Low, supra precluded District Courts within the circuit from re-examining whether a New York State Court would conclude that the residence of a plaintiff is the sole fact relevant to a determination of the State where a fraud cause of action "accrues".

In Sack v. Low this Court concluded that a Massachusetts Statute of Limitations should be applied to bar a fraud action in the Southern District of New York because the plaintiffs who had purchased publicly-traded securities resided in Massachusetts. That conclusion was explicitly based on the prediction that, there being "no New York decision directly in point" (478 F.2d at 365), the New York courts would follow the "traditional" albeit "rigid" and "discredited" rule found in Section 377 of the First Restatement of the Conflict of Laws (1934) that a cause of action for fraud accrues where the economic impact of the fraud is felt -- "normally the plaintiff's residence". (478 F.2d at 366).

To the extent that Sack v. Low represented a 1973 "prediction" as to the approach New York courts would take, if confronted by the need to determine where a cause of action for non-negligent tort accrues, the continued applicability of

its "holding" that the First Restatement Rule controls necessarily depends upon the subsequent indicia from New York courts bearing on the question. Although Judge Friendly's conclusion in Sack v. Low may have been reasonable when made, a subsequent New York court decision indicates that he may have underestimated the capacity of New York courts to reject what he characterized as a "discredited" approach and to adopt the "sensible approach" already applied by New York courts to negligent torts under the principles of Babcock v. Jackson, 12 N.Y.2d 473, 191 N.E. 2d 279 (1963).

In 1974, more than a year after Sack v. Low, Judge Irving Younger in a thorough and well-reasoned opinion concluded that the "center of gravity" or "grouping of contacts" doctrine of Babcock should also apply when confronted by the question of determining the State where a non-negligent tort has accrued is involved. Federal Insurance Company v. Fries, 355 N.Y.S. 2d 741 (Civ. Ct. N.Y. Co. 1974). The Federal Insurance case is particularly significant for the case at bar since the "sole issue" there was whether the Statute of Limitations had run. In reaching his decision, Judge Younger recognized what Judge Friendly had found -- that no prior New

York case applied the grouping of contacts doctrines to a non-negligent tort -- but, contrary to Judge Friendly, concluded that "since the Court of Appeals [of New York] has not intimated that its holding in Babcock is limited to negligence cases, the contacts must be grouped." (355 N.Y.S. 2d at 746).

Although, "under some conditions" a Federal District Court may find controlling state law to be different from principles adopted by an inferior state court, it is nevertheless incumbent upon the Federal authority to give "proper regard" to all relevant rulings of such State Courts. See Commissioner v. Estate of Bosch, 387 U.S. 456 (1967). As this Court observed in Roginsky v. Richardson-Merrell, Inc., 378 F.2d 832, 851 (2d Cir. 1967), "the rulings of a state nisi prius judge" should be treated "with respect" as to the content of state law in the absence of definitive precedent from the highest court of the state. In view of the fact that Judge Younger's decision in Federal Insurance rejected an approach that Judge Friendly himself had characterized as "rigid" and "largely discredited" in Sack v. Low, that decision should be treated not merely "with respect" but as the best indication of the position New York State courts would take on the issue therein dealt with.

Insofar as the opinion in Federal Insurance was written by a highly-regarded judge (now a Professor of Law at Cornell University Law School) and reflects consideration of the competing policies bearing on the choice of law question, it deserves to be followed. This conclusion is reinforced by the description of Judge Younger's opinion as "marvelous" found in the Supplementary Practice Commentaries to Section 202 of the New York CPLR in 7B McKinney's Civil Practice Law and Rules - Pocket Supplement at p. 13*. It is further reinforced by the fact that Judge Friendly himself had expressed less than "complete confidence" in the application of his own "prediction of New York Law" in Sack v. Low (478 F. 2d at 367).

B. The Court below misunderstood dictum in Sack v. Low which suggested that loss from the fraud there alleged might have accrued in New York if facts such as are present in the case at bar had existed.

In Sack v. Low Judge Friendly expressly recognized that

> "The problem is that the record does not contain sufficient facts to enable us to apply our prediction of New York law with complete confidence. We do not know exactly how plaintiffs paid for the securities - whether by check sent from Massa-

*The statement in the Supplementary Practice Commentaries that "It can be expected that much more will be heard on this problem [where does a cause of action accrue for purposes of the borrowing statute] in the future." Further indicates that the Court below erred in considering Sack v. Low to be the final word on the subject.

> chusetts or in some other fashion; perhaps if the plaintiffs maintained an open account at defendant's New York offices, and the loss was reflected in that account, this might make some difference. Similarly, we do not know how the securities were handled." (478 F.2d at 367-68).

In the present case, unlike Sack v. Low, the record discloses the precise manner plaintiffs' securities were paid for and were maintained and handled as open accounts in New York. As Judge Friendly had anticipated, where, as here, the record reveals that the property plaintiffs were fraudulently induced to part with was located in New York at the time they parted with it in the first instance and was located in New York when plaintiffs' interests therein were extinguished, the loss occurred in New York not at plaintiffs' residence.

The record here contains undisputable evidence that, though the plaintiffs were long term residents of the State of Washington, they had also for a long term done business in the State of New York with a broker by the name of Thomas McNell and it was Mr. McNell who brought the opportunity to invest in Blair to their attention. Prior to that time they had maintained accounts with Mr. McNell at two other brokerage

houses in New York City and for a period of five years had maintained an account with Blair in New York. (App. 408-09). After discussions with a Mr. Hepburn of Blair over the telephone forms were sent by Blair from New York, including those forms relating to approval by the New York Stock Exchange. Some of these forms were signed by plaintiffs in blank and were sent back to New York for completion, consideration and approval. Plaintiffs' "payment" for the securities involved was largely in the form of an in-house transfer of securities already on deposit in plaintiffs' existing accounts with Blair in New York to the SDN Accounts which Blair opened for plaintiffs, also in New York. (App. 409). To be sure, plaintiffs mailed to Blair in New York additional securities and checks representing approximately 10 percent of their total investment. (App. 409). However, plaintiffs did not actually post with that consideration and collateral until later when the Blair Board and the Exchange completed the necessary paperwork and gave the requisite approvals in New York and the transactions became effective. Plaintiffs never received any certificates evidencing their stock in Blair. If those certificates were ever prepared, they were retained by Blair: if they were not prepared, plaintiffs stock investments were merely book entries in New York.

The record here is also clear that plaintiffs' SDN Accounts were handled as "open accounts" and that their losses accrued upon the extinguishment in New York of their interests in New York assets. Plaintiffs received such reports as they did from Blair in the State of New York, and they maintained contact and at all times relied upon Mr. McNell in New York in the handling of their accounts. In fact, in April and May of 1970, they executed trades in their SDN Accounts in New York prior to the time the accounts were liquidated.

In any event, unlike Sack v. Low, the record in the present case establishes that the plaintiffs' relevant property was located in New York at all times when plaintiffs' relationships to that property changed (by reason of actions taken by defendants or others in New York) resulting in the losses plaintiffs incurred. If plaintiffs had invested in a second mortgage on buildings in New York City which had been rendered valueless upon foreclosure of a first mortgage in proceedings in a New York court, it would seem beyond argument that plaintiffs' losses would have occurred in New York. The fact that plaintiffs invested in open SDN Accounts and stock - all of which was located in New York and secured by New York collateral - does not cause the locus of their loss to shift from New York to the

State in which they happen to reside.

The opinion of the Court below recognized that the dictum in Sack v. Low makes it

> "clear that the Court did not single out the place where the account was maintained as the sole or controlling criterion for determining where the cause of action accrued. The method of payment, and other details were also considered important factors." (App. 520).

However, instead of analyzing the relevant factors and details in the present case - an analysis Sack v. Low plainly requires - the Court below singled out the plaintiffs' residence "as the sole or controlling cirterion for determining where the cause of action accrued." (App. 521). If the simplistic standard thus applied by the Court below - a cause of action for fraud accrued where loss is "experienced first and foremost" by the injured party - the loss incurred by the same book entries and transfers in New York which extinguished both plaintiffs' interests in their SDN Accounts and collateral securities in New York would have given rise to a cause of action in Florida (even though Florida had no relevant connection with any aspect of any transaction) if one or both plaintiffs had moved his residence to that State the day, week or month before either Blair's

bankruptcy or the date of plaintiffs' discovery of the fraud. If guidance to defendants concerning the time dimensions of their potential liabilities is an objective to be served, mechanistic application of a test based solely on residence at the time of loss of discovery of fraud, serves no purpose since potential defendants may be totally ignorant of and in any event can never be certain where that residence is on the critical dates.

C. Even if Washington Statute of Limitations were to be found to be applicable, the federal equitable tolling doctrine prevents plaintiffs' Counts based on <u>Section 10(b) from being barred.</u>

The federal equitable tolling doctrine determines when a state statute of limitations begins to run and tolling doctrine is to be read into every federal law in the absence of Congressional action. <u>Morgan v. Koch</u>, 419 F.2d 993 (7th Cr. 1967). This th inion below seemed to recognize insofar as it alluded to certain evidence concerning discovery by plaintiffs that Blair had concealed its true financial and operational status from them at the time of their purchase. (App. 523-24).

The evidence submitted by the individual defendants and relied upon by all defendants with respect to the purported discovery of the plaintiffs' claims herein, relates to Blair and its

condition not to the fraud perpetrated by the Exchange and the individual defendants. In any event, the Stockwell letter of July 23, 1970 (App. 523) relied on by Judge Brieant as the date of discovery <u>preceeded</u> the date of Blair's bankruptcy and thus preceeded the date the causes of action accrued. As Exhibits 1 through 4 to the Hannan Affidavit demonstrate, within three months after the July 23 letter, a restraining order had been obtained with respect to prosecuting any actions against Blair and that restraining order continued in effect until October 2, 1973. (App. 413-14).

Apart from the question as to the legal effect of a restraining order independent of the equitable tolling doctrine, the defendants have simply not shown that discovery of the fraud occurred prior to the conclusion of the bankruptcy proceedings. What the evidence does show is that the plaintiffs were concerned and were aware of the impending conversion of their secured demand note accounts and that Blair had critical capital problems which ultimately culminated in the bankruptcy. The record indicates that first the plaintiffs had actual knowledge of the facts relating to any potential claim against the Exchange was on or about March 23, 1973 when plaintiff Stockwell addressed a letter to the Clerk of the United States District Court with

respect to a class action lawsuit (Carr v. NYSE) which had been filed against the Exchange as a result of the sale of Blair securities to others also subsequent to Blair's acquisition of Schwabacher & Co. (App. 524).

That plaintiffs were unaware of their possible claims against anyone other than Blair until long after the Blair bankruptcy is further shown by Stockwell's February 1975 letter to McNell requesting documentation with respect to plaintiffs' purchases so their attorneys could ascertain their rights. (Stockwell deposition at 57-63, 65-70).

The federal equitable tolling doctrine unquestionably applies in "10b-5" cases. de Haas v. Empire Petroleum Company, 435 F.2d 1223 (10th Cir. 1970); Maine v. Leonard, Inc., 64 F.R.D. 714 (W.D.Va. 1973); Seiffer v. Topsy's International, Inc., 64 F.R.D. 714 (D.Kan. 1974); Korn v. Merrill, CCH Fed. Sec.Rpt. ¶ 95,355 (S.D.N.Y. Oct. 31, 1975). The Maine case says it explicitly: "In a situation involving fraud in which relief asked for is based on the Exchange Act, Section 10(b) and SEC Rule 10b-5, it is settled that the State law of the forum will determine the applicable statute of limitation while federal law will determine when the applicable statute begins to run". (p. 1280).

Bailey v. Glover, 88 U.S. 342, 21 Wall 342, 22L.Ed. 636 (1875) first articulated the standard of discovery under the federal tolling doctrine: "where the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered though there be no special circumstances or efforts of the party committing the fraud to conceal it from the knowledge of the other party." The Main opinion, supra, confirms that the Bailey standard for discovery in federal cases is still viable: "Federal law since the case of Bailey v. Glover has been that in cases involving elements of fraud that a statute of limitations can be said to begin to run when the fraud is, or upon reasonable inquiry and due diligence should have been discovered.

In de Haas, supra, the court states that "several cases since Bailey have attempted to clarify what quantum of knowledge the plaintiff must possess in order to set the statute of limitations running." The analysis in Tobacco and Allied Stocks, Inc. v. Transamerica Corp., 143 F.Supp. 323, 332 (D.Del. 1956) affd. 224 F.2d 902 (3rd Cir. 1956) sums up the applicable law: "It is impossible to lay down any general

rule as to the amount of evidence or number or nature of evidential facts admitting discovery of fraud. But, facts in the sense of indisputable proof or any proof at all, are different from facts calculated to excite inquiry which impose a duty of reasonable diligence and which, if pursued, would disclose the fraud. Facts in the latter sense merely constitutes objects of direct experience, and as such, may comprise rumors or vague charges if of sufficient substance to arouse suspicion. Thus, the duty of reasonable diligence is an obligation imposed by law solely under the <u>peculiar circumstances of each case</u>, including existence of a fiduciary relationship, concealment of the fraud, opportunity to detect it, position in the industry, sophistication and expertise in the financial community, and knowledge of related proceedings." (Emphasis added)

As the Exchange conceded in the Court below, most of the facts set forth in the complaint come from the records and files of the Exchange.* It is absurd to suggest that these facts which could only be obtained pursuant to a request for document production in a pending litigation - <u>Carr v. NYSE</u> - could reasonably have been independently discovered by these plaintiffs prior to that time.

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*The documents from the Exchange records include Blair documents which tie in the individual defendants.

Seiffer v. Topsy's, supra, stressed that a determination under the tolling doctrine of the time when plaintiffs, in the exercise of due diligence, should have discovered participation by the Exchange and the individual defendants in the alleged fraud is an issue for the trier of fact and which should not be determined summarily except where there is no room for dispute. The appropriateness of a summary judgment in this context is discussed in Rickel v. Levy, 370 F.Supp. 751 (E.D.N.Y. 1974): "In considering the claims we realize that the question of whether reasonable diligence to discover the facts was exercised often turns on the interpretation to be given to differently perceived events; such factors often make the granting of a summary judgment inappropriate. However, in particularly clear cases, summary judgment may be granted. This is especially true where plaintiffs' own version of the facts demonstrates without any doubt that he could have discovered the fraud within the time to bring the suit if he had exercised reasonable diligence." (emphasis added)

The fact that the Opinion below relies solely on evidence indicating plaintiffs' early awareness of a possible claim against Blair suggests that the Court below accepted what the

record clearly shows - that plaintiffs had no awareness of possible claims against the Exchange or the individual defendants until years later.

Thus, the Court's conclusion in the face of the record before it represented resolution without trial of hotly contested factual issue concerning the state of plaintiffs' knowledge and the reasonableness of their failure to learn of defendants' frauds sooner. Given the standard applicable, this was error.

D. Under the decision in American Pipe, the statute of limitations was tolled until April 1976 by Carr v. New York Stock Exchange, U.S.D.C. N.D.Cal. No. C-73-0367.

In American Pipe and Construction Co. v. Utah, 414 U.S. 538 (1974), the Supreme Court unambiguously held that

> "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action." (414 U.S. at 554)

In the present case, there can be no dispute that Carr v. New York Stock Exchange, a purported class action involving fraud claims against the Exchange substantially the same as those alleged in this action, was begun before expiration of the

Washington limitations period. Nor can it be disputed that, once the complaint in Carr was amended to clearly include the plaintiffs in this action, the present plaintiffs would have been members of the class represented in Carr if Carr had been "permitted to continue a class action". Indeed, if Carr had been certified as a class action, plaintiffs would have been given formal notice and, had they chosen not to opt out of the Carr action, this action would have become dismissable by reason of a prior pending action in which their claims would have been litigated on the merits. Since the amendment to the complaint in Carr expanding the class therein alleged asserted claims which "arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading" and did not change the party against whom those claims were asserted, the amendment clearly related back to the date of the original complaint. Rule 15(c) FRCP. Thus pursuant to American Pipe , Carr suspended the statute of limitations as to plaintiffs claims as of the 1973 date when that action began. Goldstein v. Regal Crest, Inc., 62 F.R.D. 571 (E.D. Pa. 1974); See also District Judges' Conference, 64 F.R.D. 475, 503 (1974). The statute was so suspended until a reasonable time after the court refused to certify Carr as a class action (Carr v. New York Stock Exchange, 1976 CCH Fed.

Sec. L. Rep. ¶95,563 (May 3, 1976)). See Jimenez v. Weinberger, 523 F.2d 689 (7th Cir. 1975).

The Court below ignored the fact that the amended complaint in Carr related back to the date the original complaint had been filed and concluded that American Pipe would not operate to suspend the statute of limitations apply until the date the proposed amended complaint was first filed - a date after the Washington limitations period had expired. In so ruling, the Court ignored the fact, implicit in American Pipe, that statutes of limitations will not bar recovery of damages by class members if claims by the class representative are not barred. Any other result would require examination in every class action of the possibility that statutes of limitations may bar claims by some class members, particularly where, as here, the applicable statute is found dependent of the class members' residence. Such a requirement that individual statute of limitation issues be litigated as to class members even where no such issue exists as to the class representative, is wholly at odds with well-founded practice in class actions where timeliness of the class representatives claim controls.

* * * * *

In view of the foregoing, genuine issues as to material facts require resolution by trial before the three-year statute of limitations of Washington may be found applicable to bar plaintiffs' fraud claims under the 1934 Act and under common law. These facts relate to the manner by which plaintiffs' SDN Accounts were handled in New York as localized property with the result that plaintiffs suffered their injury in New York. The disputed facts also relate to plaintiffs' failure to learn of their claims against the Exchange and against the individual defendants until 1973. The summary judgment dismissing the fraud claims was error and should be reversed.

II

The authority over member firms delegated to the Exchange pursuant to Section 6 of the 1934 Act carries with it an obligation to enact rules for the protection of investors in member firms

The Court below based its decision dismissing Count XII of plaintiffs' Complaint on the proposition that the Exchange had no duty to enact adequate rules for the protection of subordinated lenders. In that respect the Count erroneously assumed that a rule comparable to Rule 313(d) adopted by the Exchange in 1971 would have served no purpose prior to 1970 because stock

in member Firms was not freely transferable in the open market before 1970 (App.530). According to the Count, "Failure to have a rule such as 313(d) at that time was not a breach of duty under § 6" because "public offerings of member organization securities were impermissible in 1969, when plaintiffs made their investment." (App.530).

The fallacies in the Count's reasoning are apparent. The fact that the Exchange adopted Rule 313(d) demonstrates that registration of the Exchange under Section 6 carries with it a duty to enact rules and regulations "appropriate in the public interest or for the protection of investors." Cf. Section 6(a)(2). Since 313(d) was adopted by the Exchange it would be disingenuous for the Exchange to argue that Congress has not imposed any "responsibility and trust" in the Exchange and its employees in protecting the investing public, or that the Exchange has no responsibility for the adoption of rules beyond rules expressly mandated by the Securities and Exchange Commission. Cf., Collins v. PBW Stock Exchange, Inc., 1976 CCH Fed. Sec. L. Rep. ¶ 95,610 (E.D. Pa. 1976); New York Stock Exchange, Inc. v. Sloan, 394 F.Supp. 1303 (S.D.N.Y. 1975). The fact that, as the Court below correctly observed, public offerings of member Firms' securities were impermissible prior to 1970 establishes

that the offerings of Blair Securities to plaintiffs with the Exchange's knowledge and blessing were violations of law which could be accomplished precisely because there was no procedure comparable to that now found in Rule 313(d) to prevent such violations. In shaft, for the very reason that public offerings by member firms were prohibited prior to 1970, a file establishing procedures to ensure compliance (such as Rule 313(d)) was even more appropriate than after the offerings become pasmissible subject only to compliance with registration requirements of the Securities Act of 1933.

Furthermore, the Court below's reliance on Rich v. New York Stock Exchange, 522 F.2d 153 (2d Cir. 1975) form the proposition that § 6 does not support an action against an exchange for failure to enact "a rule enforcing" disclosure with respect to its member's securities, is misplaced. All that Rich can fairly be said to hold as a general principle is that the Exchange has a duty of supervision although it must be applied realistically as essentially a negligence standard (522 F.2d at 155). The Court in Rich never addressed the question here presented whether the Exchange's duty includes an obligation to adopt procedures ensuring member firm compliance with securities laws in connection with the issuance of their own

securities, particularly after violations by member firms had come to the Exchange's attention. Indeed, given the general nature of the Exchange's obligations alluded to in Rich, it would seem that the existence of a particular obligation in any given case would raise questions of fact as to the reasonableness of the Exchange's omissions.

CONCLUSION

The decision of the Court below summarily dismissing Counts I through IV, XII and XIII should be reversed and the case should be amended for trial.

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Respectfully submitted,

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